

STATE OF DELAWARE  
DEPARTMENT OF NATURAL RESOURCES AND  
ENVIRONMENTAL CONTROL  
HAZARDOUS SUBSTANCE CLEANUP FUND

FINANCIAL STATEMENTS

JUNE 30, 2007

STATE OF DELAWARE  
DEPARTMENT OF NATURAL RESOURCES AND  
ENVIRONMENTAL CONTROL  
HAZARDOUS SUBSTANCE CLEANUP FUND  
JUNE 30, 2007

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## INDEPENDENT AUDITORS' REPORT

The Honorable John A. Hughes  
Secretary, Department of Natural Resources  
and Environmental Control  
89 King's Highway  
Dover, Delaware 19901

We have audited the accompanying statements of assets and fund balance – cash basis - of the Hazardous Substance Cleanup Fund as of June 30, 2007 and 2006, and the related statements of revenue collected and expenditures paid – cash basis – for the years then ended. These financial statements are the responsibility of the Department of Natural Resources and Environmental Control's (the Department's) management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 2, the Department prepares the Hazardous Substance Cleanup Fund's financial statements on the cash basis, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the cash and unencumbered cash balances of the Hazardous Substance Cleanup Fund, as of June 30, 2007 and 2006, and the revenues it collected and expenditures it paid for the years then ended on the basis of accounting described in Note 2.

## INDEPENDENT AUDITORS' REPORT (Cont'd.)

In accordance with Government Auditing Standards, we have also issued our report dated November 14, 2007, on our consideration of the Department's internal control over financial reporting for the Hazardous Substance Cleanup Fund and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

*McBride, Shopa & Co*

Wilmington, Delaware  
November 14, 2007

STATE OF DELAWARE  
DEPARTMENT OF NATURAL RESOURCES AND  
ENVIRONMENTAL CONTROL  
HAZARDOUS SUBSTANCE CLEANUP FUND  
STATEMENTS OF ASSETS AND FUND BALANCE  
(CASH BASIS)  
JUNE 30, 2007 AND 2006

ASSETS

	<u>2007</u>	<u>2006</u>
Cash	<u>\$28,459,866</u>	<u>\$29,190,899</u>

FUND BALANCE

Reserve for Encumbrances	\$ 4,191,516	\$ 2,942,781
Unreserved	<u>24,268,350</u>	<u>26,248,118</u>
TOTAL FUND BALANCE	<u>\$28,459,866</u>	<u>\$29,190,899</u>

The accompanying notes are an integral part of these statements.

STATE OF DELAWARE  
DEPARTMENT OF NATURAL RESOURCES AND  
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HAZARDOUS SUBSTANCE CLEANUP FUND  
STATEMENTS OF REVENUE COLLECTED AND EXPENDITURES PAID  
(CASH BASIS)  
YEAR ENDED JUNE 30, 2007

	<u>Administrative Account</u>	<u>Cleanup Fund</u>	<u>Holding Account</u>	<u>Total</u>
REVENUE				
Tax Assessments	\$ -	\$ -	\$15,344,495	\$15,344,495
Interest	-	-	1,276,112	1,276,112
Other	<u>24,515</u>	<u>-</u>	<u>8,344</u>	<u>32,859</u>
TOTAL REVENUE	24,515	-	16,628,951	16,653,466
EXPENDITURES				
Cleanup Program	<u>1,855,668</u>	<u>15,528,830</u>	<u>-</u>	<u>17,384,498</u>
TOTAL EXPENDITURES	<u>1,855,668</u>	<u>15,528,830</u>	<u>-</u>	<u>17,384,498</u>
EXCESS (DEFICIENCY) OF REVENUE OVER EXPENDITURES BEFORE TRANSFERS	(1,831,153)	(15,528,830)	16,628,951	(731,032)
TRANSFERS				
Transfers in	1,923,070	17,552,532	-	19,475,602
Transfers out	<u>(768)</u>	<u>(808,519)</u>	<u>(18,666,315)</u>	<u>(19,475,602)</u>
TOTAL TRANSFERS	<u>1,922,302</u>	<u>16,744,013</u>	<u>(18,666,315)</u>	<u>-</u>
EXCESS (DEFICIENCY) OF REVENUE OVER EXPENDITURES	<u>\$ 91,149</u>	<u>\$ 1,215,183</u>	<u>\$ (2,037,364)</u>	<u>\$ (731,032)</u>

The accompanying notes are an integral part of these statements.

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STATEMENTS OF REVENUE COLLECTED AND EXPENDITURES PAID  
(CASH BASIS)  
YEAR ENDED JUNE 30, 2006

	<u>Administrative Account</u>	<u>Cleanup Fund</u>	<u>Holding Account</u>	<u>Total</u>
REVENUE				
Tax Assessments	\$ -	\$ -	\$14,330,719	\$14,330,719
Interest	-	-	810,149	810,149
Other	<u>1,668</u>	<u>-</u>	<u>7,735</u>	<u>9,403</u>
TOTAL REVENUE	1,668	-	15,148,603	15,150,271
EXPENDITURES				
Cleanup Program	<u>1,350,527</u>	<u>9,363,885</u>	<u>-</u>	<u>10,714,412</u>
TOTAL EXPENDITURES	<u>1,350,527</u>	<u>9,363,885</u>	<u>-</u>	<u>10,714,412</u>
EXCESS (DEFICIENCY) OF REVENUE OVER EXPENDITURES BEFORE TRANSFERS	(1,348,859)	(9,363,885)	15,148,603	4,435,859
TRANSFERS				
Transfers in	1,332,105	9,391,263	-	10,723,368
Transfers out	<u>-</u>	<u>(362,817)</u>	<u>(10,358,552)</u>	<u>(10,721,369)</u>
TOTAL TRANSFERS	<u>1,332,105</u>	<u>9,028,446</u>	<u>(10,358,552)</u>	<u>1,999</u>
EXCESS (DEFICIENCY) OF REVENUE OVER EXPENDITURES	<u>\$ (16,754)</u>	<u>\$ (335,439)</u>	<u>\$ 4,790,051</u>	<u>\$ 4,437,858</u>

The accompanying notes are an integral part of these statements.

STATE OF DELAWARE  
DEPARTMENT OF NATURAL RESOURCES AND  
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NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2007

**NOTE 1     SUMMARY OF OPERATIONS**

In July of 1990, the State of Delaware (the State) legislature passed, and the Governor signed, legislation establishing the State's "Hazardous Substance Cleanup Act" (HSCA). This Act establishes standards to be followed to protect the public health and welfare of citizens and the environment of the State from releases of hazardous substances. The Act also provides a funding mechanism for the program.

The responsibility for administering the Act was vested in the Division of Air and Waste Management (the Division) within the Department of Natural Resources and Environmental Control (DNREC). Two branches were created within the Division: the Superfund Branch and the Underground Storage Tank Branch which together make up the Hazardous Substance Cleanup Fund. Both branches are funded primarily by a surtax on certain petroleum products sold in the State.

The State's Superfund Branch supplements the federal government's efforts in cleaning up hazardous sites. The most serious sites in the State become the responsibility of the federal government while those that meet lesser criteria become the responsibility of the State.

The Fund's activities are accounted for as a distinct operating unit within the Division. Accordingly, the financial statements of the Fund are intended to present the assets, fund balance, revenues collected and expenses paid – cash basis – of only that portion of the funds of the State of Delaware that are attributable to the transactions of the Hazardous Substance Cleanup Fund.

The Fund is divided into three subfunds: the "Holding Account" for the collection of tax assessments and other revenues, the "Clean-up Fund" for the remediation activities of the Fund, and the "Administrative Account" for the administrative activities of the Fund.



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JUNE 30, 2007

**NOTE 2     SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Accounting.** The Hazardous Substance Cleanup Fund financial statements are prepared on the cash basis of accounting; consequently, revenues from all sources are recognized when received, rather than when earned; and expenditures are recognized when cash is disbursed, rather than when the obligation is incurred. The statement of assets and fund balance contains only cash and fund balances; the statement of revenue collected and expenses paid shows all cash receipts as revenues and all cash disbursements as expenses. Items included in other revenue are cost recoveries and permit fees.

**Encumbrances.** Encumbrances represent commitments related to unperformed contracts for goods or services. Encumbrance accounting, under which purchase orders, contracts and other commitments for the expenditures of resources are recorded to reserve that portion of the applicable appropriation, is utilized in governmental funds. Encumbrances outstanding at year-end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be honored during the subsequent year.

**Revenues.** The Fund's primary source of revenue comes from the levy of a 0.9% tax on all taxable gross receipts from the sale of petroleum and petroleum products, with the exception of crude oil.

Although funding is adequate to meet DNREC's annual expenditure plans and carryover funds exist, the cost of the future clean up of orphaned sites exceeds the money available in the Fund.

**NOTE 3     CASH**

**Cash:** "Cash" as reported on the statement of net assets represents the Fund's allocated share of cash, cash equivalents and investments under the control of the Treasurer of the State of Delaware. All cash deposited with the Treasurer by state agencies is maintained by the Treasurer in various pooled funds. The State Treasurer invests the deposited cash including cash float in short-term securities and other investments. However, the Fund may deposit or withdraw cash at any time without prior notice or penalty. Interest income

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**CASH (Cont'd.)**

is credited to the Fund based on the weighted average rate of return on the State's monies applied to the Fund's average daily cash balance. The classification of pooled cash and investments of the Fund is not determinable at the entity level. Pooled investments represent those investments in units of a pool rather than specific securities. As a result, such investments are not categorized as to risk because they are not evidenced by securities that exist in a physical or book-entry form.

***The Cash Management Policy Board:*** The Fund follows the "Statement of Objectives and Guidelines for the Investments of State of Delaware", of the State's Cash Management Policy Board (the Board). The Board, created by State law, establishes policies for, and the terms, conditions, and other matters relating to, the investment of all money belonging to the State with certain limited exceptions.

***Investment Guidelines and Management:*** The State's Cash Management Policy categorizes all cash and special purpose funds for which the State is financially accountable as follows:

- A. **Cash Accounts:** Divide the State's available cash into three parts:
  - 1) Collection and Disbursement Accounts,
  - 2) Cash and Liquidity Accounts,
  - 3) Reserve Cash (Intermediate) Accounts.
- B. **Special Purpose Accounts.** There are two primary types of Special Purpose Accounts:
  - 1) Endowment Accounts,
  - 2) Authority Accounts: The State's Authorities (State Agencies, Local School Districts and Component Units) maintain a variety of fund types, including various operating funds, bond funds and debt service reserve funds.

The Fund's accounts are considered Cash Accounts.

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**CASH (Cont'd.)**

The investment guidelines, adopted by the Board provide, among other things, that no more than 10% of the entire portfolio may be invested in obligations of any one issuer other than the U.S. Government. Investments may be made only in fixed income instruments with maturities of up to five years in certain circumstances. The State's Cash Management Policy is available on the Internet at <http://www.state.de.us/treasure/information/cash.shtml>.

**Custodial Credit Risk**

*Collateralization Requirements:* All State deposits are required by law to be collateralized by direct obligations of, or obligations which are guaranteed by, the United States of America, or other suitable obligations as determined by the Board, unless the Board shall find such collateralization not in the best interest of the State. The Board has determined that certificates of deposit and time deposits must be collateralized, unless the bank issuing the certificate has assets of not less than \$5 billion and is rated not lower than "B" by Fitch, Inc. Bank Watch. The Board has also determined that State demand deposits need not be collateralized provided that any bank that holds these funds has had for the last two years, a return on average assets of 0.5% or greater and an average equity-capital ratio of at least 1:20. If the bank does not meet the above criteria, collateral must consist of one or more of the following:

- (a) U.S. Government securities;
- (b) U.S. Government agency securities;
- (c) Federal Home Loan Board letters of credit;
- (d) State of Delaware securities; or
- (e) Securities of a political subdivision of the State with a Moody's Investors Service rating of "A" or better.

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**CASH (Cont'd.)**

Additionally, the bank must ensure that those securities pledged as collateral have a market value equal to or greater than 102% of the ledger balance(s) in the account(s) each day and ensure that securities pledged are identified as held in the State's name and are segregated on the bank's records.

At June 30, 2007, the financial institutions maintaining the Fund's deposits satisfied the criteria listed above and the deposits held by those institutions did not require collateralization.

**NOTE 4      COMMITMENTS**

DNREC has identified over 650 sites in Delaware as potential hazardous substance release sites, some of which have been assigned a higher priority (identified as posing a risk to public health, welfare, and/or the environment). These sites are being addressed either under HSCA or under the Federal Superfund Program (National Priority List), with work complete at many of the sites. Additionally, since the inception of Delaware's Voluntary Cleanup Program (begun in 1993) and the Brownfields Program (begun in 1995), 153 sites have entered the program; 173 sites are currently undergoing cleanup; and 70 sites have been cleaned up for reuse. This has resulted in the reuse of 1,485 acres of abandoned and/or underutilized properties. The cost of cleaning up the remaining sites exceeds the money currently available to the Fund.

**NOTE 5      CHANGE IN LEGISLATION**

House Bill 234 of the 144<sup>th</sup> General Assembly amended Title 7 Chapter 91 to ensure that the tax surcharge imposed by the Hazardous Substance Cleanup Act (HSCA) is paid only once, regardless of how many times petroleum products are resold, for all petroleum gross receipts received after June 30, 2007. Previously taxed petroleum products will be reported by vendors on Form 9114W and attached to their gross receipts report.

## AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Honorable John A. Hughes  
Secretary, Department of Natural Resources  
and Environmental Control  
87 King's Highway  
Dover, Delaware 19901

We have audited the accompanying statements of assets and fund balance – cash basis - of the Hazardous Substance Cleanup Fund as of and for the year ended June 30, 2007 and the related statements of revenue collected and expenses paid – cash basis – for the year then ended and have issued our report thereon dated November 14 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

### Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Hazardous Substance Cleanup Fund's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements – cash basis – and not to provide an opinion on the internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Hazardous Substance Cleanup Fund's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

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AUDITORS' REPORT ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING AND ON COMPLIANCE AND  
OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL  
STATEMENTS PERFORMED IN ACCORDANCE  
WITH GOVERNMENT AUDITING STANDARDS (Cont'd.)

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Hazardous Substance Cleanup Fund's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Hazardous Substance Cleanup Fund's financial statements that is more than inconsequential will not be prevented or detected by the Hazardous Substance Cleanup Fund's internal control. We consider the deficiency described in the accompanying schedule of findings and responses (Condition 07-01) to be a significant deficiency in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Hazardous Substance Cleanup Fund's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described above is not a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Hazardous Substance Cleanup Fund's financial statements – cash basis - are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

AUDITORS' REPORT ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING AND ON COMPLIANCE AND  
OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL  
STATEMENTS PERFORMED IN ACCORDANCE  
WITH GOVERNMENT AUDITING STANDARDS (Cont'd.)

The Hazardous Substance Cleanup Fund's response to our finding identified in our audit is described in the accompanying Schedule of Findings and Responses. We did not audit the Hazardous Substance Cleanup Fund's response, and accordingly, we express no opinion on it.

This report is intended solely for the information and use of Department management, Office of the Governor, Office of Controller General, Office of Attorney General, Office of Management and Budget, Department of Finance and Office of Auditor of Accounts and is not intended to be and should not be used by anyone other than these specified parties. However, under 29 Del. C., Section 10002(d), this report is a public record and its distribution is not limited.

*McBride, Shogan & Co*

Wilmington, Delaware  
November 14, 2007

STATE OF DELAWARE  
DEPARTMENT OF NATURAL RESOURCES AND  
ENVIRONMENTAL CONTROL  
HAZARDOUS SUBSTANCE CLEANUP FUND  
SCHEDULE OF FINDINGS AND RESPONSES  
JUNE 30, 2007

**CURRENT YEAR CONDITIONS**

CONDITION 07-01 (continued from prior year):

Condition: Various businesses who were listed as having a business license did not file a gross receipt tax form. A similar condition existed in 2006 and 2005. The gross receipts tax on these businesses provides the primary source of revenue for the Fund. The Division of Revenue maintains a listing of all businesses who obtain a business license as dealers of wholesale and retail petroleum products. We selected a sample of 70 (10%) such licenses from the Division of Revenue's records. Of this sample, 44 licenses, or 63%, showed no payment activity in the past year. From our discussions with the Division of Revenue personnel, we noted that most of the licenses with no payment activity are probably closed.

Criteria: All businesses with a business license must file a gross receipt tax form. Proper internal control procedures require that any non-filers be researched for non-compliance.

Cause: Often, when such businesses close, the Division of Revenue is not notified and annual license statements continue to be generated and mailed, but they produce no response. In addition, there is no internal control in place to cross reference those businesses with licenses against those who have filed.

Effect: This could result in significant lost revenue.



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JUNE 30, 2007

**RECOMMENDATION:**

Although we agree with the Division of Revenue that most of the inactive petroleum products licenses are probably out of business, we also believe there is a risk that some may still be active but not paying their taxes. Because of the importance of the gross receipts tax on sales of wholesale and retail petroleum products to the future viability of the Fund, we recommend that the Division of Revenue or the Department of Natural Resources and Environmental Control conduct follow-up on these inactive accounts to determine whether they are truly inactive or whether there are significant unpaid taxes. This follow-up could take the form of additional correspondence, telephone contact or site visits.

**AUDITEE'S PLAN FOR CORRECTIVE ACTION:**

The Department of Natural Resources and Environmental Control will forward this finding to the Division of Revenue. The Division of Revenue is the proper entity to conduct follow-up on the inactive accounts and the possibility of unpaid taxes. Department of Natural Resources and Environmental Control management will also arrange a meeting to develop a plan working with the Division of Revenue.

**SCHEDULE OF PRIOR YEAR CONDITIONS:**

See Condition 07-01.